TSC | WILLIAM D. LAW, JR. LEARNING COMMONS

Chapter 6 Study Guide: Merchandising Operations and the Multistep Income Statement

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1. Introduction to Merchandising Operations

- A **merchandising company** purchases finished goods from suppliers and sells them to customers. The primary goal of a merchandising company is to earn a profit by buying products at a lower cost and selling them at a higher price.
- **Merchandising Cycle**:
  - **Purchasing**: Buying inventory from suppliers.
  - **Selling**: Selling the inventory to customers.
  - **Cost of Goods Sold (COGS)**: The direct costs of producing the goods sold by the company.
- **Inventory**: Merchandising companies must track their inventory, which is the goods purchased for resale. The cost of these goods is critical for determining the company's profitability.

2. Types of Merchandising Companies

There are two common types of merchandising companies:

- **Retailers**: Sell goods directly to consumers (e.g., supermarkets, department stores).
- **Wholesalers**: Sell goods in bulk to retailers or other businesses (e.g., wholesalers of electronics).

3. Inventory Systems

- **Perpetual Inventory System**: Continuously tracks inventory and updates records for every purchase and sale. This system allows real-time tracking of inventory levels and is often used in businesses with high volumes of sales (e.g., supermarkets).
- **Periodic Inventory System**: Inventory records are updated at specific intervals (e.g., monthly, quarterly). The company physically counts inventory at the end of each period to determine the cost of goods sold.

4. Key Accounts in Merchandising Operations

- **Purchases**: The cost of acquiring inventory during the period.

- **Sales Revenue**: The total amount received from selling goods.
- **Cost of Goods Sold (COGS)**: The cost of the inventory that has been sold to customers.

5. The Multistep Income Statement

The **multistep income statement** provides more detailed information than the **single-step income statement** by separating operating and non-operating activities. This format helps users better understand a company's core business performance.

The multistep income statement typically includes the following sections:

1. **Sales (Revenue)**: Total sales from selling goods or services.
2. **Cost of Goods Sold (COGS)**: Direct costs associated with producing the goods sold.
3. **Gross Profit**: Sales Revenue minus COGS.
4. **Operating Expenses**: Expenses related to normal business operations (e.g., selling, general, and administrative expenses).
5. **Operating Income**: Gross Profit minus Operating Expenses.
6. **Non-operating Income/Expenses**: Includes items such as interest income, gains or losses on sales of assets, etc.
7. **Income Before Taxes**: Operating Income plus or minus Non-operating Income/Expenses.
8. **Income Tax Expense**: The tax owed on income.
9. **Net Income**: Income Before Taxes minus Income Tax Expense.

6. Key Terms to Know

- **Merchandising Operations**
- **Inventory**
- **Cost of Goods Sold (COGS)**
- **Gross Profit**
- **Operating Expenses**
- **Operating Income**
- **Non-operating Income**
- **Multistep Income Statement**
- **Sales Revenue**
- **Perpetual Inventory System**
- **Periodic Inventory System**

Practice Questions for Chapter 6: Merchandising Operations and the Multistep Income Statement

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1. Understanding Merchandising Operations

Problem 1.1: Classifying Business Types

Classify each of the following businesses as either a **retailer** or a **wholesaler**:

- A company that sells mobile phones directly to consumers in stores and online.
- A business that sells bulk electronic components to other companies.
- A store that sells clothes and accessories directly to customers.

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2. Identifying Inventory Systems

Problem 2.1: Inventory System Identification

For each of the following scenarios, identify whether the **perpetual inventory system** or **periodic inventory system** would be more appropriate:

- A large department store with high-volume sales that uses barcodes to track each item sold.
- A small retail store that only performs inventory counts at the end of each quarter.
- A grocery store that continuously updates inventory when each item is purchased or sold.

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3. Multistep Income Statement Preparation

Problem 3.1: Preparing a Multistep Income Statement

Below are the financial details for ABC Retailers for the year ended December 31:

- Sales Revenue: $500,000
- Cost of Goods Sold: $300,000
- Operating Expenses (Selling, General, and Administrative Expenses): $80,000
- Interest Revenue: $2,000
- Loss on Sale of Equipment: $1,000
- Income Tax Expense: $10,000

Prepare a **multistep income statement** for ABC Retailers.

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4. Gross Profit Calculation

Problem 4.1: Calculating Gross Profit

ABC Retailers sold $400,000 worth of products during the year. The beginning inventory was $50,000, and the ending inventory was $60,000. Purchases during the year were $200,000. Calculate the **cost of goods sold (COGS)** and **gross profit**.

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5. Analyzing the Multistep Income Statement

Problem 5.1: Analyzing the Components of an Income Statement

Using the information from Problem 3.1, calculate:

- **Gross Profit**
- **Operating Income**
- **Income Before Taxes**
- **Net Income**

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6. Cost of Goods Sold (COGS) and Inventory Transactions

Problem 6.1: Identifying COGS and Inventory Transactions

XYZ Corp. purchased goods for resale at a total cost of $120,000. During the year, the company sold goods worth $95,000. At the beginning of the year, the company had an inventory of $40,000, and at the end of the year, the inventory was valued at $30,000. Calculate the **cost of goods sold (COGS)**.

Answers to Practice Questions

Problem 1.1: Classifying Business Types

- A company that sells mobile phones directly to consumers in stores and online → **Retailer**
- A business that sells bulk electronic components to other companies → **Wholesaler**
- A store that sells clothes and accessories directly to customers → **Retailer**

Problem 2.1: Inventory System Identification

- A large department store with high-volume sales that uses barcodes to track each item sold → **Perpetual Inventory System**
- A small retail store that only performs inventory counts at the end of each quarter → **Periodic Inventory System**
- A grocery store that continuously updates inventory when each item is purchased or sold → **Perpetual Inventory System**

Problem 3.1: Preparing a Multistep Income Statement
Multistep Income Statement for ABC Retailers for the Year Ended December 31:

- **Sales Revenue**: $500,000
- **Cost of Goods Sold (COGS)**: $300,000
  - **Gross Profit**: $500,000 - $300,000 = **$200,000**
- **Operating Expenses**: $80,000
  - **Operating Income**: $200,000 - $80,000 = **$120,000**
- **Non-operating Income**:
  - Interest Revenue: $2,000
  - Loss on Sale of Equipment: -$1,000
  - **Income Before Taxes**: $120,000 + $2,000 - $1,000 = **$121,000**
- **Income Tax Expense**: $10,000
- **Net Income**: $121,000 - $10,000 = **$111,000**

Problem 4.1: Calculating Gross Profit

- **Cost of Goods Sold (COGS)**:
  - Beginning Inventory: $50,000
  - Purchases: $200,000
  - Ending Inventory: $60,000
  - COGS = Beginning Inventory + Purchases - Ending Inventory
  - COGS = $50,000 + $200,000 - $60,000 = **$190,000**
- **Gross Profit**:
  - Gross Profit = Sales Revenue - COGS
  - Gross Profit = $400,000 - $190,000 = **$210,000**

Problem 5.1: Analyzing the Components of an Income Statement

Using the data from Problem 3.1:

- **Gross Profit** = $500,000 - $300,000 = **$200,000**
- **Operating Income** = $200,000 - $80,000 = **$120,000**
- **Income Before Taxes** = $120,000 + $2,000 - $1,000 = **$121,000**
- **Net Income** = $121,000 - $10,000 = **$111,000**

Problem 6.1: Identifying COGS and Inventory Transactions

- **COGS** = Beginning Inventory + Purchases - Ending Inventory
- COGS = $40,000 + $120,000 - $30,000 = **$130,000**